

avoid similar mistakes by adopting the fundamental reforms listed here. Given the potential impact, the Commission cannot do less.

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	
	)	
Treatment of Operator Services	)	CC Docket No. 93-124
Under Price Cap Regulation	)	
	)	
Revisions to Price Cap Rules for AT&T	)	CC Docket No. 93-197

**BELL ATLANTIC<sup>5</sup> COMMENTS**

This rulemaking presents an historic opportunity for the Commission to embrace the changes happening in the world around it and to eliminate unnecessary regulations that impede competition and ultimately harm consumers and competitors alike. The Commission already has recognized the revolution occurring in the technology and markets it oversees. The Commission must now recognize that the time for creeping incremental reform is past. In today's rapidly changing and increasingly competitive environment, the decades-old regulatory structure inherited by the Commission is

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<sup>5</sup> The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; and Bell Atlantic-West Virginia, Inc.

outdated, anticompetitive and ultimately anti-consumer. It must be fundamentally overhauled.

Specifically the Commission should eliminate its distinction between so called "dominant" and non-dominant service providers. This means that tariffs for new services, new service options, and alternative pricing plans should be authorized to be filed on one day's notice without cost support. The Commission should also eliminate price regulation for these same services. This means that these new services should not have price cap restrictions imposed upon them and the superfluous and outdated Part 69 waiver process should be eliminated. Price regulation for all remaining services should be removed just as soon as there are competitive alternatives available. The standard for removal should be grounded in the presence of competitive providers with a real ability to limit price. The LECs should also have the flexibility to define the relevant scope of services to be removed from price caps -- whether based on geography, service or customer-segment. Finally, for the time services remain in price caps, the Commission should allow downward pricing flexibility without restrictions and should modify the interexchange basket to include all operator services that compete with interexchange services. These rule changes would truly meet the dramatic changes in the market and provide the greatest benefit for telecommunications provider and customer alike.

## **I. The Revolution is Here**

Static regulation with only incremental adjustments has no place in the revolution that is occurring today. As understood by Chairman Hundt, "[t]he communications

revolution is for the 21st century what the industrial revolution has been for the last several hundred years: a destroyer of the status quo, an ineluctable force for change, a source of fear and turmoil, a harbinger of a higher quality of life.”<sup>6</sup> The immediacy and importance of this revolution has been recognized by both the Administration<sup>7</sup> and Congress.<sup>8</sup> Most dramatically, with overwhelming majorities in both the House and the Senate, Congress is rewriting fifty years of communications laws to reduce regulation, encourage competition and encourage new services.<sup>9</sup>

Indeed, fundamental changes have already taken place in telecommunications. Since 1988, telecommunications technology has “advanced substantially” and competition has extended into the market for local services.<sup>10</sup> “New telecommunications

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<sup>6</sup> “Arm in Arm, We Welcome the Communications Revolution,” Speech by Reed Hundt, Columbia University Third International Training Conference for Telecommunications Regulators (Oct. 20, 1995).

<sup>7</sup> “We’ve all become used to stumbling over clichés in our efforts to describe the enormity of the change that is now underway and the incredible speed with which it is taking place. Often we call it a revolution -- the digital revolution. . . . The word revolution by no means overstates the case.” Remarks as Delivered by Vice President Al Gore to the Superhighway Summit, Royce Hall, UCLA (Jan. 11, 1994).

<sup>8</sup> Congressman Jack Fields refers to this year’s telecommunications bill as a “telecommunications revolution bill.” *Broadcasting & Cable*, June 26, 1995, at 24.

<sup>9</sup> *See* H.R. Rep. 204, 104th Cong., 1st Sess. 47 (1995) (“H.R. 1555. . . promotes competition and reduces regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourages the rapid development of new telecommunications technologies); S. 652, 104th Cong., 1st Sess. § 4 (1995) (“This Act is intended to establish a national policy framework designed to accelerate rapidly the private sector deployment of advanced telecommunications and information technologies and services to all Americans . . . ).

<sup>10</sup> *Amendment of Part 69 of the Commission’s Rules Relating to Private Networks and Private Line Users of the Local Exchange*, CC Docket No. 87-530, Order, ¶ 3 (rel. Nov. 7, 1995).

services, such as advanced applications using the Internet, have proliferated.”<sup>11</sup> Not surprisingly, the regulation of access services has also changed including the advent of open network architecture, expanded interconnection, and the transport rate restructure.<sup>12</sup>

At the same time, the pace of competition has accelerated. As Bell Atlantic and others demonstrated in the prior filings in the price cap review docket, LECs face competition in every major market area in the country.<sup>13</sup> This is particularly true in concentrated areas such as those served by Bell Atlantic.<sup>14</sup> While competition has continued to expand in the interim,<sup>15</sup> the competitive terrain for interstate access services -- the relevant markets for Commission consideration -- has fundamentally altered in the short time since those comments were filed.

Most significantly, AT&T -- the largest customer for access services -- has shifted from years of denying any intent to compete with LECs' local and access services<sup>16</sup> to a

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<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *See* Affidavit of Richard E. Beville in Support of Comments of Bell Atlantic, CC 94-1 (filed May 9, 1994) (“Beville Affidavit”); Harris Affidavit at 12-13; Peter W. Huber, *The Enduring Myth of the Local Bottleneck* (attached to ex parte letter of Pacific Telesis Group, dated Mar. 15, 1994).

<sup>14</sup> Beville Affidavit at ¶ 3 & Exhs. 1 & 3.

<sup>15</sup> For example, competitors' facilities (collocation and fiber) cover customers accounting for approximately 50% of Bell Atlantic's total interstate revenues.

<sup>16</sup> “We have repeatedly stressed that AT&T is not interested in re-entering the local telephone business . . .” AT&T press release (Aug. 16, 1993) (quoting AT&T Chairman Robert E. Allen).

declaration of competitive war.<sup>17</sup> To carry out that war, it is reported that "AT&T will unveil a partnership with one or more so-called alternative access providers, allowing it to bundle local, long distance, and cellular services, even, possibly, cable TV and enhanced features such as voice mail -- into a single AT&T brand offering."<sup>18</sup> Indeed, AT&T is already testing joint marketing of its services with those of Continental Cablevision.<sup>19</sup> AT&T's shift not only presents a competitive alternative with vast financial resources and a customer base larger than any LEC, but suggests that LECs could face imminent loss of their largest access customer, potentially endangering a majority of their access revenues.

MCI and Sprint have been similarly busy. MCI will buy as much as \$600 million in equipment this year alone as part of its \$2 billion effort to place fiber-optic loops in the most lucrative markets in order to provide "one-stop shopping for local and long distance telephone, data and video services."<sup>20</sup> Sprint has joined into an alliance with major cable television providers that would give it direct access to millions of customers homes.<sup>21</sup>

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<sup>17</sup> "We will fight for the right to give our customers a choice for local service through every option open to us -- that includes reselling local services, using alternate providers and building our own telephone network facilities." AT&T press release (Oct. 26, 1995) (quoting AT&T Chairman Robert E. Allen).

<sup>18</sup> "Ma Bell Rides Again," *Business Week* at 42 (Nov. 13, 1995).

<sup>19</sup> Under the trial taking place in the Chicago area, customers of both companies are eligible for substantial discounts including free HBO services and periods of free long distance calling. AT&T press release (Nov. 13, 1995).

<sup>20</sup> G. Naik, "MCI Plans to Buy Equipment to Offer Local Phone Service," *Wall Street Journal* at B6 (Mar. 6, 1995).

<sup>21</sup> "Sprint alliance with TCI, Comcast and Cox will spend \$2.3 billion over next 3 years building competitive local service using cable systems and Sprint brand name." *Communications Daily* at 2 (Mar. 30, 1995).

This proceeding represents the Commission's opportunity to bring the antiquated regulatory structure it inherited into line with today's environment. While the Second Notice recognizes the problems, it offers solutions that are, at best, only incremental improvements over the status quo. The Commission should take this historic opportunity to correct its rules so that new and competitive services are encouraged.

## **II The Commission Should Eliminate Its Affirmatively Anticompetitive Dominant/Non-Dominant Distinction**

The Commission should not continue to impose lengthy advance notice requirements and other regulatory burdens only on so-called "dominant" carriers -- a policy that economists, the courts and the Commission itself agrees is harmful to competition. While telegraphing prices and costs to competitors is competitively harmful under any circumstance, it is particularly harmful when required of only those carriers deemed to be "dominant" in a market. As a result, the Commission should eliminate its disparate filing requirements for dominant and non-dominant carriers.

In authorizing AT&T to file tariffs on one-day notice with no cost support, the Commission understood that the prior requirements "functioned more as hindrances to true rivalry than as consumer safeguards."<sup>22</sup> It simply makes no economic sense to make the largest provider of a service give advance notice of its costs and prices prior to launching a new service or promotion. Such notice facilitates the creation and

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<sup>22</sup> *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, FCC 95-427, Order, Separate Statement of Commissioner Susan Ness (rel. Oct. 23, 1995) ("AT&T Non-Dominance Order").

maintenance of a “price umbrella” that allows smaller competitors to price higher than they would had they not had the benefit of such competitive intelligence.<sup>23</sup> For example, one large customer of Bell Atlantic found that competitive access providers (“CAPs”) had “very carefully calculated” their price quotes so that each quote was “exactly the same percent less than Bell Atlantic’s price.”<sup>24</sup>

The Supreme Court also has suggested that it makes no “sense” to require the firm “most likely to be a price leader” to file costs and rates in advance.<sup>25</sup> Indeed, it has pointed out that voluntarily sharing the very pricing information that the Commission *requires* dominant carriers to file could spark enforcement of the antitrust laws absent government compulsion.<sup>26</sup>

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<sup>23</sup> As explained by Professor Paul MacAvoy, that is exactly what happened in the long distance industry: “Regulatory conditions in markets for long-distance telecommunications clearly changed in directions that favored acceptance of AT&T’s tariffs as the benchmark and of stability in market shares based on adherence to that tariff.” “The filing of tariffs as specified under the price cap plan allowed other carriers the opportunity to obtain advance information on any change in AT&T’s complete pricing plans.” P. MacAvoy, *The Failure of Antitrust and Regulation to Establish Competition in Markets for Long-Distance Telephone Companies*, Yale School of Management Working Paper Series C, No. 44 at 93 (Nov. 1995).

<sup>24</sup> J. Haring and H.M. Shooshan, *Universal Competition in the Supply of Telecommunications Services: Eight Customer Perspectives*, p. 35 (dated Feb. 8, 1995) (quoting the Director of Telecommunications Planning and System Design at Marriott International, Inc.) (“Universal Competition Study”).

<sup>25</sup> *MCI Telecommunications Corp. v. American Telephone and Telegraph*, 114 S. Ct. 2223, 2233 (1994). *See also Southwestern Bell Corp. v. Federal Communications Commission*, 43 F.3d 1515, 1520 (D.C. Cir. 1995) (expressing support for the economic sense of the Commission’s arguments that no tariffs should be required for non-dominant carriers, but citing the Supreme Court view that the logic applies even more strongly to dominant carriers.)

<sup>26</sup> *MCI Telecommunications Corp. v. American Telephone and Telegraph*, 114 S. Ct. 2223, 2233 (1994).



Eliminating the advance notice and cost support filing requirements unquestionably lowers regulatory costs and reduces the time for new services to get to market. There is simply no sound economic basis for requiring a competitive test as a prerequisite for eliminating the advance notice and cost support requirements for tariff filings. On the contrary, as explained in the sections below, eliminating the lengthy advance notice requirements imposed only on so-called “dominant” carriers would create no risks to justify continuing the existing process.

### **III. Commission Rules Should Encourage New Service Introduction By *All* Companies By Eliminating Regulatory Barriers**

The Telecommunications Act requires that the Commission must “*encourage* the provision of new technologies and services to the public.”<sup>27</sup> Despite this requirement, the current rules delay the introduction of new interstate services by the LECs, and serve to affirmatively *discourage* the development of new technologies and services. In order to facilitate its statutory mandate and provide the benefits of new technologies and services to consumers, the Commission must remove the regulatory hurdles it now imposes on bringing a new service to market.

#### **1. Eliminate the Part 69 Waiver Requirement**

As set forth above, the telecommunications industry is undergoing revolutionary changes and today’s marketplace for interstate access services resembles the market in

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<sup>27</sup> 47 U.S.C. § 157 (a) (emphasis added).

the early 1980's in only the most superficial sense. Despite this fact, the current rules still require LECs to submit to a pre-approval process before even filing a tariff for any new switched access service that does not conform to a generic pricing structure established more than a decade ago. Indeed, the standard for approval of a Part 69 waiver includes a requirement that the service "was not anticipated when the Part 69 Rules were adopted."<sup>28</sup> The existing Part 69 waiver process is both unsound policy and unlawful and must be abolished.

From a policy perspective, the harm of this superfluous waiver requirement is not just the regulatory waste. Part 69 waivers have no preset time limit. The result is a process that has taken more than a year and a half for some services and on average takes more than eight months before a tariff can even be filed.<sup>29</sup>

The impact of that harm is not surprising. Delay of new services means that customers lose new choices and LECs lose business opportunities.<sup>30</sup> Even a few months delay in the introduction of a new service can mean the difference between success and failure for a new service, and creates a significant disincentive to introduce the service in

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<sup>28</sup> See, e.g., *Ameritech Operating Companies, et. al, Petitions for Waiver of Sections 69.4(b) and 69.106 of the Commission's Rules*, 9 FCC Rcd 7873, ¶ 25 (Com. Car. Bur. 1994).

<sup>29</sup> See, e.g., *The Bell Atlantic Telephone Cos. Petition for Waiver of Sect. 69.112 of the Commission's Rules To Offer Facilities Management Service*, DA 94-374 (filed April 4, 1994) (pending for more than 18 months). As of November 20, Bell Atlantic's price cap era average wait for action on a Part 69 waiver was 8.4 months.

<sup>30</sup> See Affidavit of Richard J. Gilbert and Robert G. Harris at ¶ 8-9, 12-15 (attached hereto at Tab 1) ("Affidavit of Gilbert and Harris").

the first place.<sup>31</sup> As a result, the built-in delay can well mean that customers *never* receive the opportunity to purchase the new service. For example, new services introduced by Bell Atlantic have overwhelmingly been services that are not subject to a Part 69 Waiver requirement.<sup>32</sup> Given that many of these new services were Special Access services that could have had a Switched Access equivalent,<sup>33</sup> it is clear that the waiver requirement has had a chilling effect on new services.

At the same time, elimination of the waiver requirement creates no regulatory concerns. To the extent there are legitimate complaints about specific new service offerings, they are more effectively dealt with in the complaint process, where the details of the service offering will have already been spelled out in a tariff, and where problems can be resolved without delaying or derailing the introduction of the service.

From a legal perspective, the waiver requirement unlawfully circumvents specific time limits mandated in the Communications Act. Under the Act, the Commission is specifically forbidden from requiring more than 120 days notice for a new service charge.<sup>34</sup> The current Commission rules, however, require a period that exceeds this limit

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<sup>31</sup> Indeed, one study found that even a six month delay -- shorter than the normal Part 69 Waiver delay -- will result in a loss of one third of the lifetime profits for a potential service. Affidavit of Gilbert and Harris at n.5.

<sup>32</sup> Only 12% of Bell Atlantic's new service filings have been subject to a waiver requirement.

<sup>33</sup> For example, while special access SONET and FMS service are available, waivers are still pending for the switched access counterparts of these services. *The Bell Atlantic Telephone Cos. Petition for Waiver of Parts 69.110, 69.111 and 69.112 of the Commission's Rules to Offer IntelliLight Services and SALT* (filed Feb. 22, 1995); *The Bell Atlantic Telephone Cos. Petition for Waiver of Sect. 69.112 of the Commission's Rules To Offer Facilities Management Service*, DA 94-374 (filed April 4, 1994).

<sup>34</sup> 47 U.S.C. §§ 203(b)(1), 203(b)(2)

before a LEC is even authorized to *file* a tariff for the proposed service. The result is to unlawfully circumvent the statute by creating a pre-tariff review process designed to defeat the statutory time limit.<sup>35</sup> And, by placing the burden on the LEC to justify a waiver, the existing process flies in the face of the legal admonition that new services be encouraged with the burden of proof on those arguing that a new service is inconsistent with the public interest, rather than the company proposing the new service.<sup>36</sup>

## **2. Eliminate Price Regulation of New Services and Alternative Pricing Plans**

The Commission should immediately remove price regulation on new services, new service options and alternative pricing plans. Not only is there no reason to make a competitive showing before obtaining such relief, it would be anticompetitive to establish such a requirement. Removing these services from price regulation mean that tariffs for these services will be filed on one day's notice with no cost support -- as they should be for all services -- and that further price changes will not be subject to the price cap rules.

While one-day tariffs should be allowed for all services, this result is especially appropriate in the case of new services.<sup>37</sup> Tariff reviews of Bell Atlantic services have

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<sup>35</sup> *See MCI Telecommunications Corp. v. AT&T*, 114 S. Ct. 2223, 2231 (1994) ("... an agency's interpretation of a statute is not entitled to deference when it goes beyond the meaning that the statute can bear..."). Moreover, even apart from the specific time limits on tariff filings, the Act requires Commission review of any new service be resolved within one year. 47 U.S.C. § 157(b). The current waiver process, which has no time limit, in form and in practice violates this rule as well.

<sup>36</sup> 47 U.S.C. § 157(a).

<sup>37</sup> *See Gilbert and Harris Affidavit at ¶¶ 16-19.*

delayed introduction of new services as much as 83 days<sup>38</sup> and 45 days on average (in addition to the typical 45 day notice period). Ironically, customers suffer the brunt of the harm from these delays

Moreover, often delays occur where no legitimate concerns are raised.<sup>39</sup> To the extent some services never are brought to market because of these delays, the harm to customers is even greater. Regardless, the Commission retains jurisdiction under the complaint process to deal with any concerns raised by potential competitors or customers.<sup>40</sup> The difference is that the service will be available to customers in the meantime.<sup>41</sup>

Likewise, removing these services from price regulation creates no regulatory concerns to offset the clear public benefit from encouraging the development of these

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<sup>38</sup> See, e.g., Bell Atlantic Tariff FCC No. 1, Trans. Nos. 700, 740 & 751.

<sup>39</sup> For example, Bell Atlantic's Group Link Video was introduced to compete with established providers of the service including AT&T and Sprint. Bell Atlantic demonstrated that its proposed rates were at or below those of other competitors. Nevertheless, Bell Atlantic's tariff was delayed two months beyond the forty-five day delay inherent in the notice rules because of a meritless complaint by a potential competitor that the proposed rates were too high. See *Bell Atlantic Telephone Companies, Revisions to Tariff F.C.C. No. 1*, Trans. No. 776, Order (Com. Car. Bur. rel. Aug. 17, 1995); see also *Bell Atlantic, Revisions to FCC Tariff No. 1*, Trans. No. 772, DA 95-1565, Order (Com. Car. Bur. rel. July 14, 1995) (service delay on complaint of a single competitor).

<sup>40</sup> 47 U.S.C. § 208(a) ("Any person . . . complaining of anything done or omitted to be done by any common carrier subject to this Act . . . may apply to said Commission by petition.")

<sup>41</sup> Moving disputes to the complaint process will also have the beneficial effect of reducing the number of frivolous filings by reducing the incentive of those parties that "game" the regulatory process by filing objections that have no other purpose than to delay the introduction of a competitive service.

services.<sup>42</sup> New services are discretionary by definition.<sup>43</sup> If the service is overpriced or otherwise flawed, the market will reject the service. To the extent the market accepts the service, it means that customers believe they are better off buying a service at the tariffed rate than not buying the service. For alternative pricing plans, potential buyers will continue to have the original tariffed service as an option. They will only buy the new service to the extent they are better off.

Once a new service is being offered, the Commission should not impose price regulation, regardless of the level of competition. As Professor Alfred Kahn, the dean of regulatory economists, explained in the first comment round of this proceeding:

The logic of extending the deregulation of all effectively competitive services to all new services -- whether or not subject to effective competition -- is straightforward. To the extent that services are truly new, the conception of monopoly power in their provision is of dubious meaning or significance. New services offer customers additional alternatives not available to them previously. In the broader sense, therefore, their introduction is fundamentally competitive rather than a monopolistic phenomenon, . . .

There is no reason to deny an innovator the rewards of being first -- denial would inhibit innovation -- and it should not matter whether the innovator is an LEC or a new entrant.<sup>44</sup>

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<sup>42</sup> See Gilbert and Harris Affidavit at ¶ 20.

<sup>43</sup> See Affidavit of Alfred E. Kahn at ¶ 30, attached to Reply Comments of Bell Atlantic, CC 94-1 (filed June 29, 1994) ("Kahn Affidavit") (attached hereto at Tab 2). The only potential exception to this rule are mandated interconnection services. While customers of these services are also better off getting the service to market faster, and retain the ability to challenge a rate once the service introduced, the Commission may nonetheless wish to leave such new services subject to price regulation to prevent price increases.

<sup>44</sup> *Price Cap Performance Review for Local Exchange Carriers*, CC Docket 94-1, Reply Comments of Bell Atlantic, Affidavit of Alfred E. Kahn, ¶¶ 30-31 (filed June 29, 1994); see also Gilbert and Harris Affidavit at ¶ 20.

The same logic holds for alternative pricing plans -- "optional discounted offerings of services that have been, and continue to be provided."<sup>45</sup> So long as the original service remains price controlled -- either through regulation or competition -- the alternative pricing plan should not be price regulated. Customers will only buy from the alternative pricing plan if the plan makes them better off than had they continued with the original service. No matter what the alternative pricing plan terms, no customer is worse off than they would have been if the option had not been available.<sup>46</sup>

Reforming the regulation of new services and alternative pricing plans will have other pro-competitive ancillary benefits. It would allow LECs to introduce term and volume discounts. These discounts are an efficient pricing mechanism that are almost universally employed in other industries.<sup>47</sup> It is perverse logic to argue that no customers should be able to take advantage of these discounts unless all customers can do so. If some receive the discounts they are better off, and the customers who do not qualify or do not choose to participate are no worse off. Moreover, the Commission requires that common carrier services be available for resale, which provides an opportunity to effectively aggregate customers so that all can qualify for the discounted price.<sup>48</sup> This potential price arbitrage eliminates any remaining concern that term and volume

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<sup>45</sup> Second Notice, ¶ 54.

<sup>46</sup> Gilbert and Harris Affidavit at ¶ 20.

<sup>47</sup> *Id.*, ¶ 23; Affidavit of William E. Taylor at ¶ 25, attached as Exhibit A to Reply of Bell Atlantic, Tariff FCC No. 1, Trans. No. 741 (filed March 6, 1995) ("Taylor Dover Affidavit").

<sup>48</sup> *See Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities*, 60 FCC 2d 261 (1976), *aff'd American Telephone and Telegraph Co. v. FCC*, 572 F.2d 17, *cert. denied*, 439 U.S. 875 (1978).

discounts can cause *unreasonable* price discrimination.<sup>49</sup> LEC competitors who complain about term and volume discounts only wish to perpetuate regulatory impediments to more aggressive pricing.

Similarly, reforming the regulation of new services should include allowing LECs to engage in contract pricing -- tariff packages of multiple services that are designed to meet specific end-user consumers needs. Absent such authority, these needs are either met by other companies -- who frequently are not the most efficient provider -- or not met at all.<sup>50</sup> Allowing LECs to respond to their customers' needs is distinctly pro-consumer and pro-competitive.<sup>51</sup> Moreover, as with other optional services, no customer is harmed from the addition of new service packages.<sup>52</sup>

#### **IV Price Regulation Should Be Removed As Soon As There is a Competitive Alternative Present.**

To the extent competition acts as a check on price, there is no basis for continued price regulation. The Commission has recognized that price cap regulation only needs to

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<sup>49</sup> See Taylor Dover Affidavit at ¶ 28.

<sup>50</sup> As the Commission recognized for AT&T, it retains statutory authority to ensure that rates are just, reasonable and non-discriminatory and, in the context of a complaint or enforcement proceeding, can require the filing of the underlying contract to ensure that contract tariffs reflect the underlying agreements and do not violate core regulatory concerns. AT&T Non-Dominance Order, ¶ 132.

<sup>51</sup> See, e.g., Universal Competition Study at 37 (director of Telecommunications Planning & System Design for Marriott International notes that while Marriott would like to find vendors to provide telecommunications services at competitive prices "[t]he current tariff structure impacts [Marriott's] ability to meet that goal.").

<sup>52</sup> See Gilbert and Harris Affidavit at ¶¶ 20, 23.



be left in place until competition is present.<sup>53</sup> To honor that principle, the Commission must establish a mechanism that quickly reacts to remove price regulation wherever a competitive alternative is available.

**1. Existing Services for Which Competitive Alternatives Are Available Should be Removed From Price Regulation Immediately, and Additional Services Should Be Removed As Soon As Competition Becomes Available**

When customers have one or more potential alternative service providers, these competitors provide a market-based check on prices.<sup>54</sup> So long as the potential provider has the capability and willingness to offer a competitive service, super normal pricing is checked by the market. As a practical matter, that is the only necessary test to eliminate continued price regulation. This concept, sometimes called “addressability”, is similar to the “uncommitted entrant” concept in the 1992 Department of Justice/Federal Trade Commission Horizontal Merger Guidelines.<sup>55</sup> The Guidelines treat the uncommitted entrant as if it were an actual supplier because it imposes a competitive check on prices.<sup>56</sup> If price become too high, the uncommitted-entrant will enter the market at a price level lower than the incumbent.

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<sup>53</sup> *See Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8961, 65-66 (1995).

<sup>54</sup> *See Kahn Affidavit at 13-14; and see Gilbert and Harris Affidavit at ¶¶ 26-28.*

<sup>55</sup> *See Gilbert and Harris Affidavit at ¶ 33.*

<sup>56</sup> *Id.*

The proof offered to show that a particular service area has a competitive alternative available may vary depending on the information available in that market. The Commission can set some predetermined benchmarks to limit the scope of inquiry. Evidence of price stability or decline, low entry barriers, existence of actual competitors and sophisticated customer base all are signs that a market is subject to competition. Of course, direct evidence of a competitors' presence is the best evidence. If 25% of a market is addressable, that is sufficient to act as a price check on the entire market.<sup>57</sup> As explained by Professors Gilbert and Harris, in that situation, the LEC would have to raise prices at least 25% to recover the loss of those customers -- an action that would spur further competitive losses.<sup>58</sup> In the fast moving telecommunications market, a competitor will expand to fill the market as soon as a LEC raises its prices above competitive levels. At that point, the Commission must step back and allow the competitive marketplace to function.

Indeed, as Bell Atlantic has previously demonstrated, there are already a number of services that have competitive alternatives and should therefore be removed from price cap regulation immediately. Video dialtone service is being introduced as competition to established cable operators that already make service available to over 95% of United States' households.<sup>59</sup> Bell Atlantic's high capacity services (DS1 and DS3) already have

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<sup>57</sup> *Id.*; *see also* Affidavit of Richard Schmalensee and William Taylor, attached to Comments of USTA, CC 94-1 (filed Dec. 11, 1995).

<sup>58</sup> Gilbert and Harris Affidavit at ¶ 34.

<sup>59</sup> Paul Kagan Assoc., *Marketing New Media*, p. 3 (Aug. 16, 1993) (98% of U.S. television households are passed by cable); Affidavit of Robert W. Crandall at ¶¶ 8-9, attached to Reply Comments of Bell Atlantic, CC 94-1 (filed May 17, 1995).

competitive alternatives as well. Indeed, even as long as a year and a half ago, two thirds of Bell Atlantic's high capacity demand came from areas served by competing providers,<sup>60</sup> and competitors have continued to expand in the intervening period. In addition, the services included in the interexchange basket, by definition, all compete with interexchange carriers that have a national presence.<sup>61</sup>

**2. The Commission Should Avoid Pre-Set Limitations on the Scope of Services That Can Be Grouped Together For Removal From Price Cap Regulation**

Competition will not evolve according to some regulatory plan. Competition will spread to wherever competitors perceive a market opportunity. In some cases, such as video dialtone service, an entire service may face competition anywhere it is offered by a LEC.<sup>62</sup> In other circumstances, competition may vary depending on customer characteristics. For example, competition is increasing at a far faster rate for multi-line business customers than it is for single-line customers.<sup>63</sup> Competition may also develop on different geographic bases for different services. For example, as CAPs develop their

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<sup>60</sup> Beville Affidavit at ¶ 34.

<sup>61</sup> In establishing this basket, the Commission acknowledged that these services compete with AT&T. *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd 6786, ¶ 207 (1990) ("Price Cap Order").

<sup>62</sup> Crandall Affidavit at ¶¶ 8-14.

<sup>63</sup> Indeed, the divisions may be even more discrete. For example, rules on customer information recognize categories for business customers with 20 or more lines. *See Computer III Remand Order*, 6 FCC Rcd 7571, n.159 (1991).

networks, they offer competitive alternatives to all potential customers within a given radius of their lines.<sup>64</sup>

Because it is the marketplace and not the Commission or the LECs that control the scope of competition, it makes no sense to pre-define a "market" that is eligible to be removed from price regulation. This means that the Commission should not include a specific market definition as part of the criteria for removing services from price regulation. As long as LECs can make the appropriate factual showing for the service boundaries they define in a petition to remove price constraints, LEC services within those boundary definitions should be removed from price regulation.<sup>65</sup> There can be no competitive harm from such a flexible standard, because LECs still must make a competitive showing before any relief is granted. Moreover, the relief will be limited to those areas where the competitive showing can be made. Thus, services that have no competitive alternative will remain under price regulation.

### **3. Market Share is the Wrong Test**

Market share is a backward looking measure that can fail to capture the presence of competitive alternatives. Firms with very high market share may lack sufficient

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<sup>64</sup> Beville Affidavit at ¶¶ 8-9. Indeed, competitors may first target a small geographic area and then expand their facilities to meet demand after it has a sufficient number of customers already signed up. *See Price Cap Performance Review for Local Exchange Carriers*, CC Docket 94-1, Comments of Citizens For A Sound Economy at 11 (filed May 9, 1994); R. Posner, "The Appropriate Scope of Regulation in the Cable Television Industry," *Bell J. of Econ. and Mgmt. Sci.* at 98, 112 (1972).

<sup>65</sup> *See* Gilbert and Harris Affidavit at ¶ 24-30.

market power to control prices.<sup>66</sup> This is especially true if, as it is for most LEC interstate services, there is unconstrained entry and exit for potential competitors.<sup>67</sup> Indeed, the Commission recognized that a market share test was not essential when it declared AT&T a non-dominant carrier.<sup>68</sup> Most recently, a Commission proposal suggested that notwithstanding a zero market share, video dialtone service provided a sufficient competitive alternative to cable television providers with virtually a hundred percent market share so as to obviate the need for continued cable rate regulation.<sup>69</sup>

Unlike the cable TV industry, LECs allow competitors to purchase services and compete in a resale market. As the Commission has previously held,<sup>70</sup> this provides price competition for downstream customers without the need for any sunk costs.<sup>71</sup> In such a market, historical market share figures are irrelevant.

Indeed, reliance on market share is affirmatively harmful when used to force markets to remain price regulated well after competition is present. LECs incur higher costs and are at a competitive disadvantage when operating under price regulation rather

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<sup>66</sup> *Id.*, ¶ 36.

<sup>67</sup> *Id.*

<sup>68</sup> "It is well established that market share, by itself, is not the sole determining factor of whether a firm possesses market power." AT&T Non-Dominance Order, ¶ 68.

<sup>69</sup> *Waiver of the Commission's Rules Regulating Rates for Cable Services*, CUID Nos. NJ0213, NJ0160, Order Requesting Comments (rel. Nov. 6, 1995).

<sup>70</sup> *See, e.g., Competition in the Interstate Interexchange Marketplace*, 5 FCC Rcd 2627, 2630 (1990); AT&T Non-Dominance Order, ¶ 61.

<sup>71</sup> Indeed, because customers make no distinction as to whether or not a competitive alternative is a reseller, there should be no requirement that addressability be limited to "facilities-based" suppliers. *See* AT&T Non-Dominance Order at ¶ 70. The only question is whether customers have a viable competitive alternative. *See* Gilbert and Harris Affidavit at ¶¶ 26-36.

than under market conditions. If the Commission were to continue that one-sided burden until the LECs suffer a significant loss of market share, the Commission would be imposing a regulatory burden that skews the market results with no benefit to consumers. Indeed, to the extent the LEC is the more efficient provider, by adding costs to the service, the Commission would be increasing costs to consumers -- all in the name of the public interest. The Commission must resist inevitable calls by LEC competitors to mandate a market share test that prolongs the competitors' regulatory advantage over the LECs at the expense of the public.

**V. The Commission Should Adopt Pro-competitive Reforms for the Price Regulation of Services Remaining Under Price Caps**

As set forth above, the Commission must overhaul its rules to allow new services and pricing structures into the market without regulatory delays. For existing services that remain under price caps, the Commission must avoid stifling the market by imposing excess regulatory burdens.

**1. No Limits on Downward Price Adjustments**

There is simply no justification for downward price constraints on price regulated services. The only justification for any price regulation is a lack of competitive check on prices. This is accomplished through the price cap. While imposing a price floor supposedly offers a protection against predatory pricing, in reality this is not a genuine concern. As the Commission and the Supreme Court have recognized, while predatory

pricing is "often alleged", it is "fairly uncommon, and proven cases are rare."<sup>72</sup>

Moreover, there is no reason that predatory pricing is more likely in the markets LECs compete in than in other markets. Indeed, LECs regulated under pure price caps have no opportunity to raise prices to recover the losses inherent in predatory pricing.<sup>73</sup> At the same time, the LECs face large well financed competitors that are unlikely to be pushed out of the market.<sup>74</sup> The existing networks of the interexchange carriers and the cable TV operators have low marginal costs and could survive any price war.<sup>75</sup>

In contrast, downward pricing limits put a real constraint on a LEC's ability to lower prices. Limiting upward price adjustments for a LEC that has lowered its prices below the price caps produces a similar disincentive to make price reductions.<sup>76</sup> Allowing a LEC subject to a price cap to price flexibly so long as it is below the cap is consistent with Commission policy and offers the best chance for reduced prices.

Moreover, the Commission retains the complaint process to investigate allegations of predatory pricing. The test in such proceedings is the true price floor --

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<sup>72</sup> **LEC Price Cap Order**, 5 FCC Rcd at 6824 (1990); **Matsushita Elec. Ind. Co. v. Zenith Radio Corp.**, 475 U.S. 574, 588-93 (1986).

<sup>73</sup> **See Affidavit of William E. Taylor at ¶ 12**, attached as Exhibit 1 to Opposition of Bell Atlantic to Petition to Deny and Response to Comments, Statement and Protest, W-P-C 6912, W-P-C 6966 (filed Aug. 11, 1994) ("Taylor 214 Affidavit").

<sup>74</sup> **See Beville Affidavit.**

<sup>75</sup> **See Crandall Affidavit at ¶ 19.** Moreover, even in the unlikely event a major competitor were to leave the market, any facilities owned by that competitor would be purchased and would continue to be a source of competition for LEC services.

<sup>76</sup> **See Gilbert and Harris Affidavit at ¶¶ 21-22.**

incremental cost. Requiring add-ons to incremental costs is unsound economics<sup>77</sup> and customers will suffer if LECs face a regulatory price floor that is too high.<sup>78</sup>

## **2. Modify Composition and Treatment of the Interexchange Basket**

The Commission has recognized that LEC-provided interexchange services are a “separate category” of services.<sup>79</sup> As previously explained, these services are competitive and should be removed immediately. If the Commission determines that a formal showing is necessary to remove these services, it should, in the interim, continue its policy and apply the same productivity offset for these services as it applies to AT&T.<sup>80</sup> Given that AT&T is removed from price caps altogether, this means a productivity offset of zero.

In addition, as a precursor to price deregulation of these services, the Commission should modify the basket to include other operator services that compete with AT&T and other interexchange carriers. These operator services do not belong with access services and are no less competitive with interexchange carriers than the services already included

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<sup>77</sup> Kahn Affidavit at ¶ 25; Gilbert and Harris Affidavit at ¶ 18.

<sup>78</sup> Under current rules, the same concern is raised by the new service rules, which can require uneconomic loadings above and beyond incremental cost. These loadings can raise the level of the price umbrella and allow competitors to raise their prices as well.

<sup>79</sup> LEC Price Cap Order, 5 FCC Rcd 6786, ¶ 211.

<sup>80</sup> *Id.*, ¶ 207; *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8961, ¶ 249 (1995).




in the basket today. These services include call completion,<sup>81</sup> electronic directory assistance, and directory assistance.<sup>82</sup>

#### CONCLUSION

For the foregoing reasons, the Commission should adopt the reforms as set forth above.

Respectfully submitted,

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<sup>81</sup> Both MCI and AT&T offer long distance directory assistance featuring a call completion option. See promotional materials attached hereto at Tab 3.

<sup>82</sup> *See, e.g.*, "Rochester Telephone Corporation and Metromail to Offer National Directory Services," PR Newswire (Nov. 8, 1995). In addition operator transfer and busy-line verification and interrupt are discretionary non-access services that should be grouped with other operator services in the interexchange basket.